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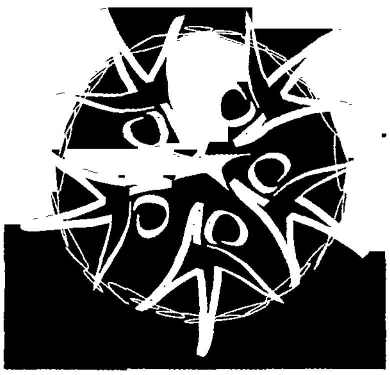

Incentives and the Role of Institutions in the Provision of Social Safety Nets

Chris de Neubourg

September 2002

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Social Protection
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Social Safety Net Primer Series

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Social Safety Net Primer Series

The World Bank Social Safety Nets Primer is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking of specialists and practitioners on the role of social safety nets in the broader development agenda. Primer papers are subject to peer review for quality control, but the format is flexible enough to reflect important developments in the field in a timely fashion.

The series contributes to the teaching materials covered in the annual Social Safety Nets course offered in Washington DC as well as various other Bank-sponsored courses. The Social Safety Nets Primer and the annual course are jointly supported by the Social Protection unit of the Human Development Network and by the World Bank Institute. The World Bank Institute also offers customized regional courses through Distance Learning on a regular basis.

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Papers in the Safety Nets Primer as of 4/02[1]

Theme	*Author*
Program Interventions	
Cash transfers	Tabor
Food related programs	Rodgers and Coates
Price and tax subsidies	Harold Alderman
Fee waivers in health	Bitran and Giedion
Fee waivers in housing and heating	Katsura and Romanik
Public works	Subbarao
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Cross-cutting Issues	
Overview	Grosh, Blomquist, and Ouerghi
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Evaluation	Blomquist
Political Economy	Graham
Benchmarking Expenditures	Besley, Burgess, Rasul
Gender and Risk	Ezemenari, Chaudhury, and Owens
Community Based Targeting	Conning and Kevane
Country Setting/Target Group	
Very Low Income Countries	Smith and Subbarao
Transition Economies	Fox
Non-contributory pensions	Grosh and Schwarz

1. Papers may be added or deleted from the series from time to time.

Abstract

Institutions matter in the design and implementation of social programs in general and for social safety net programs in particular. This paper argues that what matters most for the success of programs are the incentives that are provided to stakeholders and actors through institutions. The paper critically examines the effects of different incentive structures that operate between program providers and the sponsors of programs and between providers and clients, illustrated with reference to developed and developing country examples. In light of these incentive effects, the paper then examines possible strategies for safety net implementation under three distinct institutional settings, including limited institutional capacity, nascent development, and more mature environments.

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Incentives and the Role of Institutions in the Provision of Social Safety Nets

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I. Introduction

The best way to assess the effectiveness and efficiency of a social program is to look at its outcomes. For example, does the program reach its intended recipients or are others also benefiting? Do the benefits adequately cover the needs of the beneficiaries? Does it cover a significant proportion of those who need help? Are there other programs with similar objectives and characteristics? Often, the answers to these questions depend on the incentives facing the relevant stakeholders and actors, and these incentives are a product of the institutions that are involved in designing, administering, and supervising the program. In recent years, policymakers and analysts have increasingly recognized that the institutional environment in which a social policy operates affects its outcomes.

Incentives come in many forms. They may take the form of costs imposed on actors—financial costs, effort, time, stigma, and foregone opportunities among others. Incentives may be manifested as benefits—money, promotion, recognition, or power. Also, incentives influence the behavior of all actors involved in the design, implementation, and utilization of social programs, including policy designers, central and local administrators, and program beneficiaries.

In this paper, we will be concerned with incentives and with the role of institutions in the provision of basic social safety net programs (as opposed to social programs in general). Social safety nets are those interventions that provide cash or in-kind support or that help the poor and vulnerable in society to access basic social services. Safety nets programs include, for example, cash and in-kind transfer programs, subsidies, public works, targeted human development programs, food and nutrition interventions, and service fee waivers. While much of what ww will be describing in this paper also applies to other areas of social policy, we will concentrate on safety nets where relevant.

Part II of this paper examines the nature of social policy programs and identifies ways in which social policy and safety nets in particular present special design challenges. Part III looks at the role of incentives in delivering safety net programs, focusing on ways to address

[1] This paper was produced in collaboration with Kai Bucholtz, who prepared the study on devolution experiences in the USA, and with Christine Weigand, who prepared the empirical illustrations.
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potential incentive incompatibilities between program providers and sponsors on the one hand and providers and clients on the other. Part IV discusses the role of existing institutional structures and capacity for delivering programs and suggests possible ways to structure institutions and incentives based on three hypothetical examples of countries with differing amounts of administrative capacity. Part V sums up the discussion.

II: The Nature of Social Policy Programs

There is no such thing as the *perfect* institutional design for a social safety net program. However, details matter a great deal. Making small changes in the incentives provided to clients/beneficiaries and to administrators and decisionmakers can result in dramatic differences in the performance, efficiency, and effectiveness of the program.

All social programs require that some discretionary power and responsibilities are shifted from the central policymaking level to the providers in the field. In that context, the institutional design of social safety net programs shapes the incentives for all of the parties involved, including legislators at the central and local levels, local administrators, the monitoring agency, and the clients/beneficiaries. Thus, the incentive structure has a decisive impact on the success or failure of the program.

Theoretical Program Design

All areas of policy depend on institutional incentives and questions of institutional design. For example, relatively simple traffic legislation regarding speeding requires the same basic kind of institutional design as a social safety net program. Someone has to define its objectives both in terms of speed and the effects of limiting speed. The legal indications (such as traffic signs and speed ramps) and of law enforcement (such as radar control and police observations) have to be defined as do the way to collect fines and the role of the judicial system. The outcomes and the effects are relatively easy to monitor (in terms of the driver's actual speed of traffic, number of violations, and number of accidents), and the potential for fraud or corruption is easily audited. All of these issues have to be addressed when designing new speeding regulations.

The same general issues must also be considered in designing social policy. However, the process is much more complex because delivering services in the social sector, especially services aimed at reaching the poor, is intrinsically difficult. Ideally, the process from design to final successful implementation involves seven key steps: (i) defining the policy objectives; (ii) defining the policy instruments; (iii) securing the financing; (iv) piloting; (v) implementing; (vi) auditing; and (vii) monitoring and evaluating.

Design of Safety Nets in the Real World

In the ideal world, a social program would work exactly as designed. But the world is not ideal. Perfect programs do not exist, any more than perfect institutions do. There are at least three major reasons why it is particularly difficult to implement social safety nets: (i) the heterogeneity of service delivery; (ii) the limited existence of competitive service providers; (iii) it is difficult to adapt and adjust the design of programs during implementation.

Heterogeneity. Social programs, more than other programs, rely on local providers (individuals or small groups of individuals) to deliver services in the field. These providers will often have to operate in daily isolation with little or no supervision, and, in most cases, the program has to be implemented under different geographical, social, and economic conditions in the different parts of a country. Ethnic, religious, economic, and organizational backgrounds may differ significantly within the population, and these factors can affect how effectively the program can be implemented. For example, family structure or religion can alter the definition of what it means to be a "household." Alternatively, regional price differences that reflect the relative scarcity of certain goods or differences in opportunity costs, for example, may influence the definition of income or poverty.

Lack of Competition. Competitive markets for social service delivery are hard to create, and it is very difficult to design artificial competitive pressures to enhance the performance of providers. Clients/beneficiaries cannot register their dissatisfaction by leaving the program and even have limited opportunities to voice their concerns. As a result, they cannot provide the signals that are necessary for markets to operate. This implies that providers may have a degree of monopoly power and may not provide the services in the way that program designers had intended.

Inability to Adjust. Because of the lack of these "automatic signals," providers' delivery performance must be constantly monitored, which can sometimes be difficult and expensive. But even if monitoring is undertaken, program providers and policymakers must be able to adjust its design and implementation to prevent undesirable outcomes. However, they often do not have the incentives or the capacity to do so. In order to perform effectively:

- Providers must have detailed information on the programs and understand the philosophy behind it, its political desirability, and the degree of social acceptance that it has. They must be convinced that the program is intrinsically good and legitimate and that their efforts are important to society;
- Providers must also have the technical knowledge and equipment to perform their jobs. If, for example, the social program uses a sophisticated questionnaire to find out what means a household has, the providers should be instructed in detail on how to use the questionnaire. This goes beyond technical instruction; it requires also that the providers are trained to apply their personal judgement wisely; and
- Providers must also be trained to understand why certain rules are important in the light of the necessity of treating all citizens equally. Also, providers must be taught how to deal with the inevitable cases of inefficiencies, fraud, or misallocation due to defective rules.

III: Incentives in Social Policy Delivery

Providers and bureaucrats are no different from other officials and workers in other organizations. Their behavior depends very much on the incentives given to them. Designing these incentives is a crucial element in the management of social programs. This section explores two basic institutional mechanisms for influencing the implementation of safety net programs: those influencing relations between the provider and the sponsors of the program and those affecting relations between the provider and the clients or beneficiaries.

Providers and Their Sponsors

There are two types of financial incentives that relate to the relationship between service providers at the local level and their sponsors (usually the central government)—personal financial incentives and institutional financial incentives. These deal principally with the wage structure of providers and the larger program funding mechanisms, respectively.

Personal Financial Incentives. Setting the wage level of social service providers is a highly contentious topic. The basic difficulty is that it is nearly impossible to attribute the marginal contribution of every single person to the final output, which, in turn, does not lead to direct profits. It is equally difficult to quantify the importance of competitive salaries, internal promotion, and career stability in improving bureaucratic performance.

One might assume that the simple solution for setting remuneration levels would be to pay providers according to the prevailing levels for civil servants. This may be effective in many developed countries but not necessarily in developing countries. The potential problem stems from the fact that civil service salaries are typically significantly below the market rate for private sector workers with similar skills and qualifications (and in some cases is even below subsistence levels). Further, even meager civil service salaries often go unpaid due to fiscal constraints or government inefficiency.

The problem with such discrepancies in remuneration is that only the least-qualified individuals (or, in exceptional cases, idealists) will be willing to work for social service providers. This will eventually lead to a lack of capacity or/and to a lack of motivation on the part of providers to implement the program properly. Providers may even have an incentive to seek gainful employment on the side or to divert some of the social program's funds to themselves or to their family and friends. The effect may be somewhat reduced if wages are supplemented by non-financial remuneration (access to services such as cheaper health care or housing or to privileges such as parental leave and early retirement) or when civil servants are eligible for bonuses or have or direct (legal) access to goods. Non-competitive payment schemes often cannot be solved within the context of the institutional incentives provided by a single social program. Nevertheless, the issue can and should be counteracted at an aggregate policy level where possible. One option that has been explored in developing country settings has been to privatise the provision of social services, for example.

Institutional Financial Incentives. Social programs and social safety net provisions need to be financed. While in some cases public goods may be partially paid for by user fees (for example, public transport), this is not a viable option for social safety net programs. This means that safety nets and most social programs must be financed from taxes. This introduces a range of issues that need to be addressed when setting the institutional framework of a program:

- At what level are the taxes going to be levied?
- How are aggregate budgets going to be defined?
- At what level are individual allocation decisions going to be made?

There are two answers to each of these questions: either decisions are taken at the national (central) level or at a sub-national (local) level. Local decision-making is an increasing trend in much of the developing world, but presents a challenge to employ funding mechanisms which ensure that program expenditures can be met while creating sustainable spending incentives for local governments that frequently do not have taxing authority.

In countries where sub-national governments levy taxes, mobile tax bases are rarely relied upon (for example, income or capital gains taxes). First, poorer regions would tend to collect less tax than richer regions, although the poorer regions would probably need more public interventions expenditures. This can be counteracted by so-called "equalization funds" in an attempt to equalize conditions among the regions, but this is a difficult operation that seldom leads to satisfactory solutions from the poorer regions' perspectives. Usually, such equalization payments are based on a formula that includes one or more of the following criteria: income per capita, population, poverty (or "need"), and tax base. Alderman (1999, p. 4) suggests that, in order to target poor regions successfully, national governments need "to acquire exactly the type of information that the theory on decentralization posits they obtain inefficiently." A second problem with relying on mobile taxes is that a tax competition among regions could result which may lead to further inequality between the regions.

Sub-national tax-authorities rely largely on immobile tax bases, including taxes on land and property. Taxing immobile tax bases, however, typically results in the need for central government to redirect income from progressive national taxes to sub-national governments or providers to make up revenue shortfalls. This fiscal gap can be addressed by implementing a "revenue sharing" model in which regions receive a fixed proportion of central revenues based on factors such as their population and measured needs. Another way to address the regional gap is "tax base sharing." In this case, the central government taxes income, for example, at a nationwide level, and local governments are allowed to tax the same base for their purposes. However, as long as these taxing measures are not linked to the central government's mandates or policy objectives, there is no reason to assume that the money will be spent on social programs. Therefore, these methods are not usually used to finance social policy or social safety net programs.

Alternatively, central governments can set up grant schemes, in which the central government provides financial support to local governments either on a conditional or unconditional basis. In many developing countries where there is no taxing capacity at the local level but social programs are administered locally, grants from the central government are the only source of funding (the ultimate fiscal gap problem). Policymakers have the choice between three basic models for providing funding: open-ended capitation grants, block grants, and matching grants. Each model presents different financial incentives for the local service providers.

Under *open-ended capitation grants*, local providers of a social program are financed by a grant from a single government agent, usually a Ministry. The grant in turn is financed from tax revenues or compulsory contributions. All expenditures at the local level are covered by the capitation grant. In one popular form of the model, the costs of program administration are financed as a percentage of the social service/benefit costs plus a fixed costs provision, and the average cost per client/beneficiary is pre-set by the central government.

Using an open-ended capitation grant scheme, the local provider has the tendency to maximize output without regard to costs. Consider, for example, universal categorical benefit programs versus means-tested programs. In the former case, such as a child-benefit which is disbursed to the custodian/parent(s) of all the children in a country, the benefit is allocated based on a single simple criterion that is easy to administer and that makes fraud not impossible but difficult. In the latter case, when benefit allocation decisions are based on relatively complex criteria that require providers to make judgments, they may have a tendency to be lenient with disbursements. Because providers do not have a financial incentive to limit the expenses of the program, they may allocate benefits in borderline cases to increase output and case numbers. This is not a case of corruption, it is just a provider reacting rationally to the incentives set in the institutional design of the program.

In the insurance literature, this phenomenon is known as "a third party payment scheme." Two parties, the provider and the client, make a decision, the bill for which is paid by another party. Under such an arrangement, the third party has two ways to affect the decision—first by setting the rules and, second by monitoring and auditing the outcomes of the decisions. If the central government chooses to adopt an open-ended capitation grant scheme, it will need to pay careful attention to the design of the program in all of its aspects, especially effective monitoring and auditing.

The central government may prefer to look for another financing system that avoids these problems, such as a block grant or a matching grant (both discussed below). For example, box 1 summarizes recent financing actions taken in the Netherlands to address incentive issues for local providers of the primary social safety net program.

Box 1: Financing Arrangements and Incentives in the Netherlands

The Netherlands' primary social safety net (*Algemene Bijstandswet*) is provided through the social service departments in each of the local municipalities. Prior to 2001, 90 percent of the funding for the activities of the social service departments came from an open-ended capitation grant from the national government. The remaining 10 percent of the funding came from a block grant from the National Fund for Municipalities (*Gemeentefonds*).

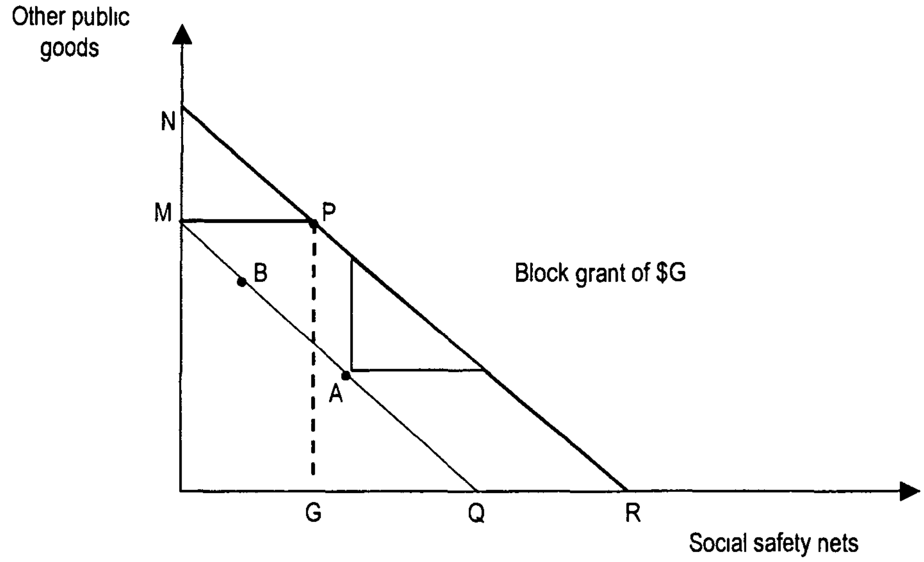
A working group that assessed the system determined that the financial incentives given to the municipalities did not adequately encourage them to seek to lower the number of beneficiaries either by reducing the number of new allocations or by stimulating the recipients to leave the social safety net. The reason for this is that municipalities do not bear the cost of providing services and are not rewarded if costs are contained and if the program's effectiveness is improved.

A new funding arrangement was initiated in January 2001, which reduced the share of the national contribution to social service costs to 75 percent, again in the form of an open-ended capitation grant. The remaining 25 percent of costs are budgeted as a block grant. However, the budgeting rules were changed so that a municipality that spends less than the budgeted 25 percent can use the difference for its own welfare and workfare policy or on other local policy initiatives. Early indications suggest that municipalities now more actively pursue policies to help beneficiaries leave the welfare rolls and find employment.

As described by Oates (1994), *block grants* effectively balance the goal of relieving the fiscal burden on local governments of program provision with the goal of limiting local competition for scarce tax resources. Block grants typically consist of a fixed amount of money transferred to local governments to supplement existing resources, provided either unconditionally or conditionally. In comparison with open-ended capitation grants, central authorities are better able to control program costs and ensure that local providers use the added resources for their intended purposes.

The potential spending outcomes and differences associated with conditional and unconditional block grants are illustrated graphically in figure 1. It is assumed that local policymakers have the choice between spending resources on the social safety net or on "other public goods" (like parks, transport, or culture) measured in dollars. The initial budget constraint is MQ. To avoid confusion, indifference curves are left out. We assume that the local government chooses the allocation represented by point A.

Figure 1: Block Grant (Conditional and Unconditional)



An unconditional block grant of size $G (=QR=MN) is represented by an outward shift in the budget constraint, from MQ to NR. As discussed by Gramlich (1977), we generally expect the consumption of both goods to increase with income (normal goods in economics jargon), so that income elasticities will be between 0 and 1.

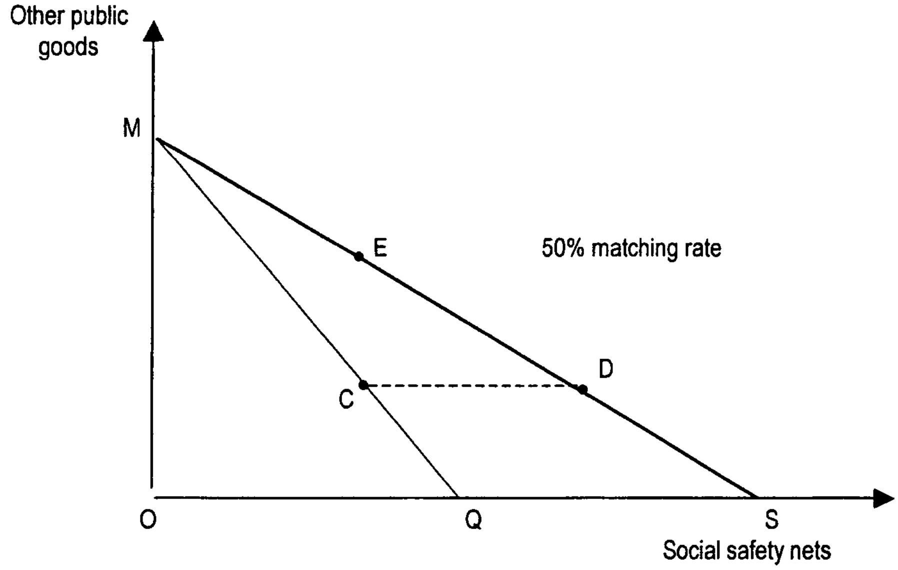
This condition implies that the after-grant spending will be somewhere on NR bounded by the end points of the shaded triangle to the north-east of initial point A. Hence, spending on social safety nets increases by a positive amount less than the grant, with the actual size of the increase depending on the income elasticities of the two goods.

If the central government provides the same grant of $G under the condition that it must be spent only on social safety nets, the new budget constraint is no longer NR but MPR in figure 1. With such a grant, a minimum expenditure ($G) on social safety nets is guaranteed, because up to point P local governments consider the social safety net a free good. If local governments spend more on both goods as income rises, then the spending outcomes will be the same under either block grant mechanism—represented by some point on NR bounded by the triangle.

However, if local government would not choose to spend more on social safety nets as its income rises (safety nets are an inferior good), then imposing conditionality could decidedly affect the level of services provided. For example, if the local government pre-grant spending allocation is represented by point B in figure 1, and safety nets are inferior goods, then an unconditional grant of $G might result in a new spending allocation on NR to the left of P. In such a case, the unconditional block grant would result in *less* overall spending on safety nets in the region. Providing a conditional grant would move the allocation to point P, ensuring at least $G are spent on safety nets.

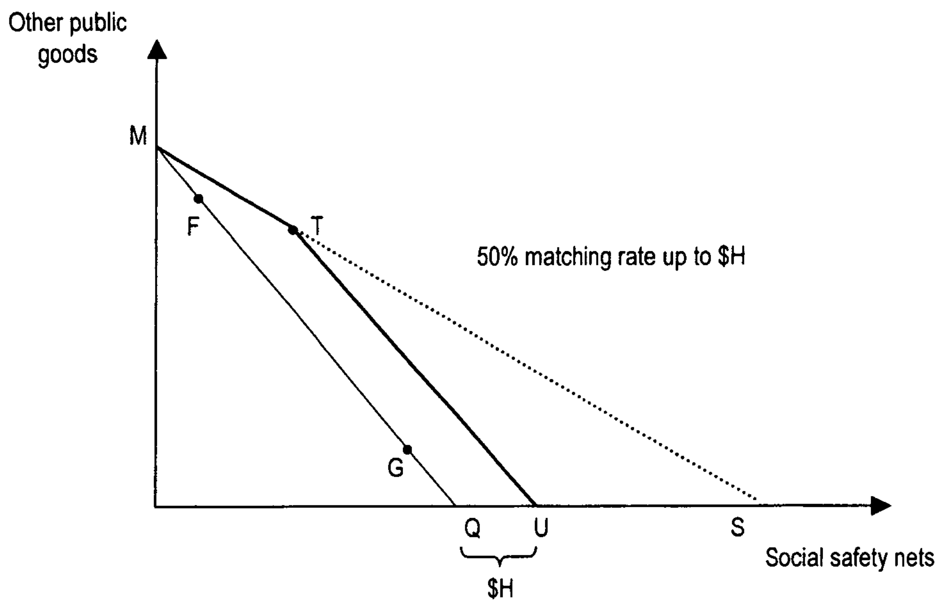
An alternative to block grants are *matching grants*. These are grants from the central authority that match a certain proportion of spending at the local level. Matching grants are applicable only in the case where local governments have some independent spending (and revenue) authority. Matching grants are preferred in theory to block grants when there are local government externalities or spillovers on other regions. Use of matching grants changes the marginal cost of social spending for the local government. In contrast to the block grants, which worked via an income effect, matching grants work via a price effect. Matching grants can be either open-ended or closed-ended. The general implications of both types of matching grants are illustrated in figures 2 and 3.

Figure 2: Open-ended Matching Grants



In figure 2, an open-ended matching grant of 50 percent shifts the budget constraint from MQ to MS. Note that the distance OQ is equal to QS because the price of the social safety net faced by the local government has decreased by one-half as a result of the grant. If the price elasticity of spending on the social safety net is unitary and the initial position is C, spending will shift to point D, the whole amount of the grant (CD in this case) being spent on social safety nets. If the price elasticity is larger than one, spending on other public goods might even decrease as a result of the grant, leading to a spending allocation on DS. (The logic behind a decrease in spending on other public goods is that the local government has to match its allocation of the increased spending on the social safety net.) In the case of price inelastic demand for social safety nets, other public goods will profit from the grant, and spending on both goods will increase (to any point on MD). However, any point to the left of E (implying a decrease in spending on social safety nets in response to receiving the grant) is not realistic because we do not expect a negative price elasticity of spending on social safety nets (or a negative income effect that outweighs the price effect).

Figure 3: Closed-ended Categorical Matching Grant



In the case of open-ended matching grants, the central government has no control over its own budget because the amount of grant that it provides depends on the spending behavior of local governments. For this reason, closed-ended matching grants are used more frequently.

If there is a limit of $H (=QU) to the matching grant, the community will face a kinked budget constraint MTU as in figure 3. For a community where the local government chooses initially not to spend much on social safety nets (point F), the grant will seem like an open-ended matching grant. It is highly unlikely that the local government with preferences yielding F in the initial position would use up the whole potential of the grant, $H. Instead, they choose a point on MT, because they do not want to sacrifice much of their consumption of other public goods in order to pay their portion of the increases in spending on the social safety net, even though its price has decreased by a half. For communities with local governments who put a high priority on spending on social safety nets (point G), the grant will have the same effect as a block grant and these governments are likely to choose a point on TU.

In general, the higher the limit $H, the more likely the grant is to work like a matching grant. And the lower the local matching rate, the more the grant will work like a conditional block grant. The central government will ideally take such considerations into account when designing a closed-ended matching grant by influencing the matching ratio as well as the cap. Matching grants have been used extensively by many western governments in response to increased program devolution. In the US, for example, until 1996 states received between one-third and one-half of their expenditures on Aid to Families with Dependent Children (AFDC)—the cash-transfer safety net predecessor to the Temporary Assistance to Needy Families (TANF) program—from the central government in the form of matching grants.

Due to the many influences and unquantifiable effects, comparing the likely impact of the different grant mechanisms is not easy. As Gramlich (1977) discusses, open-ended matching grants are the best choice if the goal of the central authority is to increase spending on social safety nets. As shown above, unconditional block grants are the least appropriate for increasing specific expenditures, but (compared with an equal grant amount under a matching system) they allow the highest utility level for the local government. Closed-ended block grants lie somewhere in between the other two models.

Some commentators view conditional central grants as a constraint on local autonomy (Bahl and Linn, 1992, p.465), while others welcome it as a way to ensure some minimum provision of public goods, especially in the case of social safety nets. It should be noted that effects of grants on local spending decisions may be even greater than predicted by standard economic models. According to theory, giving an unconditional grant to a region, for example, should have the same impact as giving an equivalent lump-sum payment to its inhabitants; some fraction of the income should be spent on current goods and services and some on other items such as investment and tax relief. Yet in practice, governments tend to spend a huge fraction of grants on goods and services. For example, many U.S. studies of the actual effect on state and local government spending of various types of federal grants suggest that nearly all grant funds are spent on public goods and services (Hines and Thaler 1995). This phenomenon is known as the "flypaper effect," a concept introduced by the economist Arthur Okun, and is captured by the phrase "money sticks where it hits." Numerous hypotheses have been put forward for this finding. An appealing explanation is that politicians benefit more politically from higher spending than from offering minor tax cuts to citizens. As a result, grants from the central authority may have a greater positive effect on local spending than theory predicts.

Providers and Their Clients

The point of contact between the providers and the clients, where the service is actually delivered, is another key issue in the design of the institutional aspects and incentives of social programs. Beautiful structures, careful preparations, and noble intentions are useless if the final delivery of the service is not good enough. Clients are influenced by several aspects of social programs even before they have any contact with the providers. It is important to note that the disbursement of a social benefit or the provision of a social program may *in itself* provide incentives for the clients. The very fact that someone gets a benefit, for example, may influence his or her attitude to their labor supply. The labor supply effects of safety nets benefits have been studied at length elsewhere and will not be addressed here (see, for example, Moffit, 1992 for discussion of the US).

To Apply or Not to Apply? There are three major reasons why potentially eligible beneficiaries would not apply for a program. These include:

- Clients are not informed about the program. Many countries have programs that are unknown to the targeted population. A recent study in Latvia, for example, illustrated that people in the poorest deciles of the income distribution simply do not know that a program exists. Similarly, in the Netherlands, 40 percent of those entitled to a housing benefit did not have information on the program. Clearly, there is a need to clearly define who has responsibility for informing the public of the existence of programs and for making sure that all groups are reached.
- Clients do not understand the program. In the Latvian case mentioned above, the social assistance legislation is so complicated that it is difficult even for researchers and

administrators to grasp. It is little wonder then that poor citizens do not comprehend it. Too complicated systems are found in many of the former Soviet Republics. In Kyrgyzstan, there are 40 dense pages listing all the benefits of the social policy sector. Not only is there a need to provide adequate information about safety net programs, but probably most programs should be streamlined and simplified.

- The opportunity costs of applying exceed the benefits. Under the Armenian social assistance legislation, for example, a mother applying for a small benefit for a disabled child has to collect many administrative documents from different sources in different locations, requiring literally days of travel and queuing. As a result, few bothered to apply. A realistic estimation of *all* of the costs that an applicant has to pay must be factored into the design of any social program.

Corruption. Corruption does not originate in the twisted minds of semi-criminal elements but in scarcity and in the rational behavior of agents. Of course, given the exact same conditions, some bureaucrats will accept bribes or tolerate deviations from the rules while others will not. This does not mean that program designers should ignore the possibility of corruption. Corruption is a serious problem especially where social programs are concerned because it can undermine the efficiency and the effectiveness of the program. Moreover, it threatens the long-term credibility of the program and of all government actions. Corruption comes in many different forms: (i) acceptance of bribes from clients; (ii) applying rules assessing eligibility or entitlements in ways that favor or hinder clients; and (iii) diverting funds, property, or revenue from the social program.

There are two distinct ways to reduce the incentives for corruption in an existing program: (i) by simplifying the program and/or (ii) increasing the costs of corrupt activities to the corrupt individual.

While bureaucrats and politicians often add additional controls, restrictions, and rules aimed at deterring corruption within a given program, this may not have the desired effect. Increasing the complexity of a program often also increases the costs of complying with the program, which may be a disincentive for many of the targeted population to participate. Moreover, complex programs are more difficult to monitor and to audit than simple programs, making it easier to hide corrupt behavior. On the other hand, simplifying a program can be a potent anticorruption strategy. This can be done by taking away any opportunity for people to undertake undesirable or corrupt activities. For example, in cash transfer programs, the chance of corruption can be reduced by minimizing the number of different individuals and locations through whose hands money must pass before it reaches the beneficiary. Instead, money can be centrally distributed using the postal service or existing banks to reduce the involvement of local officials, or it can be distributed in the form of coded cards for beneficiaries to use in stores directly. Such methods simplify the program and may simultaneously reduce corruption. However, it is not always possible to simplify effectively, especially when there are only limited technology and financial institutions at the local level at which the program is being implemented.

The second way of reducing the incentives for corrupt behavior is to increase the costs of corruption. This can be achieved by restricting the amounts of the benefits of the service or the periods during which services or benefits are distributed. This means that the corrupt providers and clients must repeat their operation, with an increased risk of being caught, and that the gains from every single operation are so limited that many parties will no longer find it worth the risk. Fostering an anticorruption climate in the country can also increase the costs of undesirable behavior through the development of a system of credible and effective monitoring and auditing and by increasing competitive pressure.

IV: Institutional Structures and Program Implementation

The earlier sections of this paper have highlighted the fact that institutions and the incentives that they create for stakeholders heavily influence the chances that a social safety net program (or any social program) will be successfully implemented. However, more broadly, the success of a program will be affected by the *existing* institutional structure and capacity that prevails in a region or country. This includes the capacity of the central and local governments, the extent to which non-governmental providers operate in the country in question and their capacities, and the extent to which communities can become involved in the administration of the programs. This section explores more fully the role of institutional structures and capacity by focusing on three generic cases: one country characterized by limited institutional capacity, one with limited but developing institutional capacity, and one with fully developed institutions.

A Country with Limited Institutional Capacity

If there is a dysfunctional bureaucracy and a lack of trustworthy law enforcement in a country, few programs can be viable if they are designed according to theory. In this situation, sometimes even after the program has been designed and the desirability of implementing it has been established, the best course may nevertheless be to abandon it. The damage done by a badly implemented program may be far greater than any benefits it could yield.

Limit the Programs. However, it may be possible to limit the program's objectives and scope. In some cases, the "best" in policy terms can be the enemy of the "good." It may be beneficial to accept certain flaws in the system in the knowledge or hope that what the program can do it will do well enough. For example, the costs of precise targeting may be too high to justify the institutional costs of implementing it, so the program's designers may choose to target by age group rather than by means testing.

In those countries where the bureaucracy in some regions or parts of the country is more functional than in other parts, the less–developed regions can sometimes be stimulated by the successes achieved in the regions with an effective bureaucracy. For example, in South Africa, some provinces have social safety net programs that seem to perform relatively well while stimulating the less advanced provinces and the central government to follow in their footsteps.

Involve the Central Government (with Foreign Support). In those countries where local capacity may be lacking but where ample capacity and legitimacy exist at the national level, there is a good chance that some programs can be implemented very successfully. Over time, the central government can transfer some of its technical and administrative capacity to the local level. For example, the guaranteed minimum income and single benefit social assistance system in Kyrgyzstan seemed unviable when it was first designed. However, it was implemented relatively successfully due to a fairly strong central institutional structure, a detailed three-year local training program, and the close involvement of international aid organizations, in this case the British Council endorsed by the World Bank and the Asian Development Bank.

Involve the Community. One of the problems in poorer countries is often the lack of ownership of safety net programs by important stakeholders in the population. This ownership can be built up on a small and local scale by involving some key local actors in the design of the program. NGOs, churches, religious leaders, and well-informed local people can be consulted during many phases near the start of the design process. In this way, central authorities can avoid making mistakes that are not clear to them but that are easy to detect at the local level. Moreover, corruption can be avoided or diminished if a local community feels that it has ownership of a program.

A further step would be to use community leaders to administer or even deliver a program. These community-based administrators can make use of their knowledge of the local social fabric to make decisions about the allocation and distribution of benefits/services. Often, if decisions are made locally, then they are seen as being more legitimate by the communities that stand to benefit from the program than if the decisions had been made at the central level. In order for devolution to function effectively, there must be a certain tradition of action at the community level, and the authority of the decision-making body should be largely undisputed.

While these conditions are seldom fully met, there are some good examples of community-based social safety net programs in developing countries. In Uzbekistan, the traditional Malhalla system is used to implementthe country's social assistance program. Under the Uzbek system, the Mahalla (a traditional gathering of community "elders") has the discretion to give assistance benefits to any household that it deems needy. General guidelines require the Mahalla to consider and record extensive information on the recipient households, but the final decision rests with the Mahalla itself. In Albania, local well-informed people play a role in the social assistance system. Alderman (2000) estimated that the allocation of benefits seems to be well-targeted as local Albanian officials seem to have more knowledge about the households in their communities than would be available to relative outsiders like central civil servants. In Tajikistan, parent-teacher commissions are used to allocate child benefits to the poorest children in school districts, but this is a recent development so there are no evaluation data yet.

Despite the fact that the examples above appear to be successful, their potential applicability on a larger scale should not be overestimated. Many conditions have to be fulfilled for extensive local community involvement in safety net programs to be effective. The level of technical capacity at the local level is frequently not sufficient and required extensive development through training and intensive supervision. There is also a danger that local leaders will not direct the program's benefits to the intended target population. In addition, local leaders may lose the support of the local community if they are called upon to undertake tasks and take decisions that may not be part of their traditionally accepted responsibilities.

A Country with Nascent Institutions

If some parts of the country's bureaucracy can function adequately, including some local governments and communities, some additional institutional options may be available. We identify two such options in this section: (i) decentralize responsibility over the allocation of safety net resources to the regional or local level to increase the effectiveness of the programs and (ii) use the emerging private sector, including NGOs, to provide effective services. A third option involving the complete devolution of the policy process will be discussed in the following section but may also be relevant to countries with a partially functioning bureaucracy and evolving institutions.

Target Safety Net Resources Geographically. Can poverty and vulnerability only be addressed by providing benefits directly to identified individuals and families or is it useful to target entire areas with predominantly poor populations? Specifically, is regional and geographic targeting a viable option in countries where the bureaucracy is not working properly? The evidence on geographic targeting is mixed but depends crucially on the program's design and on the existence of effective institutions (governmental agencies and other service providers) within the targeted region (Ravallion, 1999 and 2000 and Alderman, 2000). In those countries where a functioning bureaucracy exists, geographic targeting can be considered.

Geographic targeting usually has relatively low administrative and economic costs but of course has the disadvantage that it tends to include the non-poor among the beneficiaries. The efficiency of geographic targeting increases with the proportion of poor members in the region in question and can be further increased by using it in combination with additional targeting efforts through the community.

An example of successful geographic (and other) targeting is the Mexican *Progresa* program. Initially, 104,000 localities were ranked according to "marginality" on the basis of a set of data (including variables such as the percentage of illiterate population aged 15 years and over and the percentage of households without access to clean water, sewage, and electricity). On the basis of that ranking, 76,000 localities were selected to receive additional assistance. Within these selected localities, households were ranked according to their reported per capita income for all household members. A poverty line was constructed, and all households with a reported income below the poverty line were selected for assistance. The resulting list was then revised on the basis of feedback from the local authorities and from community members who were able to judge the real "poverty" situation of the households. The results are modestly encouraging, but a minimum amount of data of decent quality is needed to rank the localities in order to make sensible decisions.

Relying on Private Sector Service Providers. So far, we have assumed that the provider, whether public or non-public, was a local monopolist. This can be a problem since these providers have few incentives either to limit costs or to deliver a good service. The question is whether it would be possible to allow many providers to deliver a social safety net program and let them act as competitors. There are many social programs where many providers are the rule rather than the exception, mainly in health care and in education (in these cases, fixed costs capitation financing is often used). However, few safety net programs rely on competitive providers, whether for profit or not-for-profit. It is intrinsically difficult to introduce market elements into safety net programs. Private firms are not likely to be attracted by the prospect of providing the kind of services offered by these programs. In the Netherlands, attempts have been made to privatize the delivery of some social services, but in general success has been limited and total program administrative costs have actually increased. However, Uruguay's experience with privatising the school feeding program has been more positive (see box 2).

Box 2: Private Sector Involvement in Uruguay's *Programma de Alimentacion Escolar*

This school feeding program provides a meal and/or snack to needy children in primary schools located in disadvantaged areas throughout Uruguay. The eligibility of each school is determined according to measures correlated with need, such as average level of the students' mothers' education or an index of basic unmet needs. The school director then identifies those students within the selected schools who are most in need. Initially, the school's staff procured the food and prepared the meals.

An evaluation conducted in 1996 revealed that there was a large variation in the nutritional content of the meals provided under the program and that meals were costly to produce through the schools. As a result of these findings, food procurement and preparation was contracted out to private providers. The involvement of private providers has improved the quality of the meals through standardized specifications of caloric and nutritional content, and costs have been reduced.

As a rule, private subcontracting in the social sectors requires a huge commitment from the government in terms of regulating, monitoring, and training the private sector providers. However, many governments of developing countries lack this capacity. Moreover, private firms (for-profit firms as well as not-for-profit ones) require a market of at least a certain minimum size. This means that, even in health and education, private sector involvement is usually limited to densely populated urban areas. When these pre-conditions regarding market size and governmental capacity to regulate and control are met, there are various ways to encourage competition among these providers. The most popular of these are vouchers, service contracting, management contracting, lease contracts, and concessions. Each of them has its limitations. Nevertheless, despite the limitations that are traditionally associated with private sector involvement and competition, the intention to increase competitive pressure was one of the main reasons why, in some countries (notably the US), the entire process of designing and implementing safety net programs was decentralized from the federal to the state level.

An additional option for increasing the number of private sector providers may be to involve local and international NGOs more fully in public provision of safety nets. NGOs can range from large-scale international organizations such as the Red Cross, Oxfam, or *Medecins sans Frontières* to local micro-organisations that specialize in lobbying for a single local issue. They are often very well informed about special aspects of social conditions, and they often have well-established relations with parts of the community. In many cases, NGOs are extremely dedicated to their mission, and their employees or colleagues are highly motivated and committed. These are all undoubtedly positive arguments in favor of including NGOs in the implementation of some kinds of social programs. In many countries, they play an important role in the provision of health care. In Bolivia, for example, about a quarter of the health care facilities in the big cities are provided by NGOs.

However, some cautionary remarks are in order. First, NGOs often have little experience in running safety net programs. Second, the strong points of NGOs are frequently also their weaknesses; they know local situations very well, but that does not mean that they can run programs in other parts of the country or in other circumstances. As with community-based programs, the central government would still have to play a strong supervisory role, especially concerning training, monitoring, and evaluation.

A Country with Developed Institutions

Even in a nation with a fully developed institutional structure, the design and implementation of safety nets and social programs is a dynamic process. Policymakers must get the mix of programs right and must be prepared to "fine-tune" or adjust the program's operations whenever necessary in order to improve its performance. Institutionally, the programs can either be organized around a centralized bureaucracy—and this may be preferable when local government, private sector, and community capacity is limited—or they can have a more decentralized structure.

Program Mix and Fine-tuning. As a social policy system becomes more sophisticated, it usually becomes more complicated as well, which introduces new problems. One problem is that of cross-incentives. Social programs often have objectives that are interrelated and, in some cases, even contradictory. Also, the sheer number of programs in any one country creates enormous complexity. This problem is especially prevalent in OECD countries with long-standing welfare states. In these countries, social programs have been introduced over a long period and often in a piecemeal way, and little attention has been given to cross-effects and internal consistencies. In most developing countries and transition economies, many of these problems can be avoided by reforming or "fine tuning" programs to make them simpler and more consistent. Regular monitoring and evaluation will reveal what aspects are working as the designers intended, where incentives are working the wrong way, and what are the unexpected and undesired side-effects of the program. Moreover, the programs will be subject to exogenous influences.

Partial or Complete Devolution. Devolution is a concept that has received increasing attention worldwide among policymakers, principally as a result of the social safety net debate in the US. Devolution and decentralization are synonymous terms and refer to the process whereby the central government delegates certain policy decisions to a lower, more local administrative and legislative level.

One key argument in favor devolution is that local authorities are better informed about their constituents than central authorities and are in a better position to identify those in need and to ensure that they receive the program's services. This is especially true in environments in which information on the population is not readily available or where reaching the poor and vulnerable is difficult. Local officials can be invaluable in targeting social assistance to those most in need. For example, in the case of Albania, local officials use a variety of sources of information that would not be accessible to the central government. Local officials are also in a better position to monitor recipients: "Households will be less able to conceal information about their circumstances from locally based authorities than from those at the national level." (Alderman, 2000).

Another argument in favor of decentralization is the assumption that local government is more accountable to citizens because they can more easily observe and control the decisions and expenditures of authorities in their vicinity than those of the central government. The veracity of this assumption clearly depends on whether citizens in the country in question have effective control over local government. Even if true, if the funding for the social safety net comes from the central government but the program is administered locally, local authorities have no incentives to keep costs down or increase the efficiency of the program. To counteract this problem, grant schemes (as described above) can be designed to transfer funding from the central government to the locality in such a way that this accountability is maintained.

It is important that any form of devolution or decentralization be based on a clear contract between the central and local governments (see Tanzi, 1996). The responsibilities and power of each level of authority must be clearly identified, and each should be given sufficient resources to enable them to carry out their responsibilities successfully. An example from the US suggests that getting this balance right, including ensuring that there is adequate local administrative capacity, is far from easy. Several countries, including Mexico, Indonesia, and Thailand, have recently been struggling to identify the roles of institutions and governments in the context of decentralizing the delivery of safety net services.

V: Summary

The premise of this paper is that institutions matter in the design and implementation of social programs in general and of safety net programs in particular. We argue that designing a safety net program presents particular challenges given the nature of the job that these programs are supposed to do. First, helping the poor and vulnerable requires that the program should have wide coverage and access, necessitating a certain degree of decentralization of service provision and administration. Second, there are usually very few providers of safety net services, which creates certain incentive problems. Also, providers may not have the capacity or incentives to undertake the sort of monitoring and constant adjustments required to implement programs effectively.

Incentives and the Design of Safety Net Programs

There are several mechanisms and strategies that can be used to help to ensure that the incentives provided to the stakeholders and actors are compatible with the goals of social safety net programs. These can be categorized in terms of whether they relate to the relationship between providers and the program's sponsors or the relationship between providers and the program's beneficiaries.

Providers and Sponsors. Personal financial incentives are clearly a prime motivator for providers, whether from the private or public sector. Ensuring that the wage rate for civil servants and other providers is competitive with wages paid at other equivalent workplaces and adequate to the purposes of the program will go a long way toward reducing underperformance and potential corruption.

However, the financial incentives provided through the institutional structure itself are a frequently overlooked element in the success or failure of a program's design. The key issues are how programs are financed and who has the power to make spending decisions. There are several revenue-sharing mechanisms that can correct incentive problems, including matching grant schemes. But where local revenue capacity is limited, other grant schemes such as block grants can encourage local providers to spend wisely and efficiently.

Providers and Clients. Our discussion focused on the behavior of the providers and did not address how the labor market behavior of beneficiaries was affected by the program's characteristics. We did note, however, that the design of the program gives potential beneficiaries a disincentive to apply for the program, and care should be taken to avoid such consequences. This includes keeping the all of the costs associated with applying for a program low including time spent, effort, and opportunity costs. Information about the program should be freely available so potential beneficiaries can make intelligent choices.

The behavior of the providers themselves can hinder the efficiency of the program. Potential corruption—from outright bribery to selective application of eligibility rules—can undermine a program's objectives. The incentive for corrupt behavior can originate in the design of the program itself. Design features that can reduce the incentives for corruption include simplifying the program's objectives and process, such as reducing the number of administrators and officials involved in safety net transactions. Another solution may be to distribute cash directly to beneficiaries through the postal service or through electronic cards, thus reducing the involvement of officials and reducing transport and security costs. It is also possible to increase the costs of corrupt behavior by increasing oversight and monitoring activities and restricting the amounts of the benefits or the periods during which they are distributed.

Institutional Structures and the Implementation of Safety Net Programs

In addition to being influenced by funding strategies and the design features of the program itself, the effectiveness of a program is affected by whatever the macro institutional structure prevails in the country or region. There are three hybrid cases that characterize the extent of development of the institutional structure, for each of which several program design features may be appropriate.

In Countries with Limited Institutional Capacity. With a largely dysfunctional bureaucracy, the best strategy may be to limit the objectives and scope of the program to avoid making the program dependent on unreliable institutional structures. This can include involving the community through community-targeting efforts, permitting less stringent targeting rules, or limiting the program to particular regions. Alternatively, if weak local capacity is the problem, maintaining a strong central involvement can be effective, bolstered by the support of NGOs and possibly foreign donors. Coordinating the program's implementation with non-governmental bodies and local communitiesis a particularly promising strategy.

In Countries with Nascent Institutions. If some parts of the government bureaucracy function well and if private sector and local institutions are developing, other design options can be considered. These include using more sophisticated targeting methods to get resources to the regional and local levels and involving the private sector more in the delivery of safety net services.

In Countries with Fully Developed Institutions. In countries with a fully functioning bureaucracy and private sector institutions, a broader range of design options are available. Institutionally, programs can be organized around a central bureaucracy or can be decentralized; these programs can rely heavily on private providers and communities or can be run by the public sector. In any case, policymakers must be concerned with the mix of different programs and minimizing overlaps between them.

A significant strategy for increasing the overall institutional effectiveness and efficiency of social policy has been to devolve responsibility for social programs to local governments and providers. This has not been attempted on a broad basis but has been implemented in a number of countries, most notably in the US. There is as yet no conclusive evidence regarding the success of this devolution strategy, but it is important that any form of devolution or decentralization be based on a clear delineation of the responsibilities of the central and local governments with adequate provision made for funding. Devolution decisions should not revolve so much around considerations about *more or less* government but instead should aim to guarantee *good* government and good governance.

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Summary Findings

Institutions matter in the design and implementation of social programs in general and for social safety net programs in particular This paper argues that what matters most for the success of programs are the incentives that are provided to stakeholders and actors through institutions The paper critically examines the effects of different incentive structures that operate between program providers and the sponsors of programs and between providers and clients, illustrated with reference to developed and developing country examples. In light of these incentive effects, the paper then examines possible strategies for safety net implementation under three distinct institutional settings, including limited institutional capacity, nascent development, and more mature environments.

HUMAN DEVELOPMENT NETWORK

About this series...

The World Bank Social Safety Nets Primer is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking of specialists and practitioners on the role of social safety nets in the broader development agenda. Primer papers are designed to reflect a high standard of quality as well as a degree of consensus among the World Bank safety nets team and general practitioners on good practice and policy Primer topics are initially reviewed by a steering committee composed of both World Bank and outside specialists, and draft papers are subject to peer review for quality control. Yet the format of the series is flexible enough to reflect important developments in the field in a timely fashion.

The primer series contributes to the teaching materials covered in the annual Social Safety Nets course offered in Washington, DC, as well as various other Bank-sponsored courses. The Social Safety Nets Primer and the annual course are jointly supported by the Social Protection unit of the Human Development Network and by the World Bank Institute. The World Bank Institute also offers customized regional courses through Distance Learning on a regular basis.

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